Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Verizon Petition for Emergency Declaratory and Other Relief	)	**WC Docket No. 02-202**
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WORLDCOM OPPOSITION

I. Introduction

WorldCom, Inc. (WorldCom) hereby submits its comments on Verizon's "Petition for Emergency Declaratory and other Relief." In its petition, Verizon asks the Commission to allow certain tariff filings to go into effect, and requests that the Commission weigh in on the side of the incumbent LECs in bankruptcy proceedings involving the incumbent LECs' customers.

The Commission should ignore Verizon's petition. Verizon's attorneys are perfectly capable of advocating Verizon's interests in bankruptcy court without help from the Commission. And, as the Commission observes in the Public Notice,[1] the other issues raised by Verizon's petition are already being addressed in the Verizon Transmittal No. 226 proceeding and in the Winstar proceeding. Verizon's petition advances no arguments that Verizon has not already made in those proceedings and makes no new requests for relief other than to urge the Commission to act "expeditiously" in those proceedings.

[1] Public Notice, DA 02-1859, released July 31, 2002.

Certainly, Verizon's claim that the relief it seeks is necessary to "protect" the telecommunications industry from a "risk of a decline in the quality of service" is nothing more than overheated rhetoric. The sole purpose of the relief sought by Verizon is the protection of Verizon's bottom line.

In the boom years between the mid-1990s and 2001, Verizon and the other incumbent LECs did very well by selling special access and interconnection services to CLECs, ISPs, and IXCs. As demand for those carriers' data and Internet services grew, they purchased more and more special access circuits from the incumbent LECs. The incumbent LECs' special access revenues grew by almost 30 percent per year, from $4.3 billion in 1997 to $12.0 billion in 2001.[2] The rapid increase in special access revenues drove a dramatic increase in the incumbent LECs' rate of return on special access services, from 9.7 percent in 1997 to an astonishing 37.5 percent in 2001.[3] Due to the increase in special access earnings, the incumbent LECs' overall interstate rate of return increased substantially, from 15.4 percent in 1997 to 19.7 percent in 2001.[4] The incumbent LECs' interstate rate of return is now far in excess of both the Commission's most-recently prescribed rate of return of 11.25 percent and the incumbent LECs' cost of capital.

Commission decisions during the boom years magnified the contribution of the rapid growth in CLEC, ISP and IXC special access demand to the incumbent LECs' bottom line. First, the Commission eliminated sharing from the price cap plan in 1997, thus removing all limits on the incumbent LECs' interstate earnings.[5] Second, in the Access Reform Order,

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[2] http://gullfoss2.fcc.gov/prod/ccb/armis1/forms/preset/Basic_Financial_Data_Main.cfm, BOC (including GTE) data for 1997 & 2001, row 1020, column (s).
[3] Id., row 1920, column (s).
[4] Id., row 1920, column (h).
[5] Price Cap Performance Review for Local Exchange Carriers, Fourth Report and Order, CC Docket No. 94-1,

the Commission took X-factor reductions that would otherwise have been applied to special access rates and applied them to the TIC instead.[6] Third, in the CALLS Order, the Commission applied a special X-factor of only 3 percent, rather than 6.5 percent, to special access services in the 2000-2001 tariff year.[7] Fourth, in the Pricing Flexibility Order, the Commission adopted a framework under which the incumbent LECs' special access services were removed from price cap regulation in many cities.[8] Finally, in the Supplemental Order Clarification, the Commission prohibited CLECs from converting special access services to unbundled network element combinations.[9]

Having enjoyed the benefits of the growth in CLEC, ISP, and IXC customer demand for special access services during the 1997-2001 boom years, it is hardly surprising that Verizon would now feel some effects from those customers' financial difficulties. Whatever "financial fallout" that Verizon is experiencing is primarily the result of a turn in the business cycle, not the result of any shortcomings in the Commission's security deposit policies or in the courts' implementation of the Bankruptcy Code. While Verizon might like complete protection against turns in the business cycle, the Commission's security deposit policies and the Bankruptcy Code are designed to balance Verizon's interests with those of its customers, not to safeguard Verizon's interests alone.

There is no merit to Verizon's contention that "firms in other industries" are somehow able to obtain better protection than that available to Verizon. When US Airways

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released May 21, 1997, at ¶¶ 147-155.

[6] Access Charge Reform, First Report and Order, CC Docket No. 96-262, released May 16, 1997, at ¶¶ 229-238. Because the TIC was assessed on switched access minutes, for which demand was growing much more slowly than for special access, the retargeting of X-factor reductions provided the LECs with a windfall.

[7] Access Charge Reform, Sixth Report and Order, CC Docket No. 96-262, released May 31, 2000, at ¶ 149.

[8] Access Charge Reform, Fifth Report and Order, CC Docket No. 96-262, released Aug. 27, 1999.

[9] Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, *Supplemental Order Clarification*, CC Docket No. 96-98, released June 2, 2000 (*Supplemental Order Clarification).*

declared bankruptcy, the press reported that the airline's suppliers were "ponder[ing] their chances for recovery."[10] In the telecommunications industry, equipment suppliers and other CLECs have experienced "financial fallout" from the financial difficulties of ISPs and other CLECs that is at least as severe and, in most instances, more severe than that experienced by Verizon. For example, Time Warner Telecom recently reported to the SEC that its uncollectibles expense has increased substantially due to customer bankruptcies.[11] Similarly, Nortel Networks reported to the SEC that "the amount of customer financing with respect to which customers have failed to meet their financing obligations had increased."[12] In contrast to Verizon, however, CLECs and equipment suppliers have no regulators to whom they can plead for special treatment to cushion the impact of turns in the business cycle.

II. The Commission Should Reject the ILECs' Security Deposit Tariffs

In its petition, Verizon urges the Commission to allow its security deposit tariff filing, Verizon Transmittal No. 226,[13] to go into effect. But the Commission has already suspended for five months, and set for investigation, BellSouth and Iowa Telecom's security deposit tariff filings because of "substantial questions regarding the lawfulness" of those filings.[14] Verizon's tariff filing raises the same questions of lawfulness, and should likewise be suspended.

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[10] *Wall Street Journal*, "U S Airways Creditors Calculate Exposure to Struggling Carrier," August 13, 2002, p. A2.
[11] Time Warner Telecom, SEC Form 10-K, March 28, 2002, at 34.
[12] Nortel Networks, SEC Form 10-Q, August 13, 2002, at 63.
[13] Verizon Tariff Nos. 1, 11, 14 & 16, Transmittal No. 226, July 25, 2002.
[14] BellSouth Telecommunications, Inc., Tariff FCC No. 1, Transmittal No. 657, Order, released August 2, 2002, at ¶ 5; Iowa Telecommunications Services, Inc., Tariff FCC No. 1, Transmittal No. 22, Order, released July 17, 2002, at ¶ 2.

The Commission's decision to suspend and investigate the BellSouth and Iowa Telecom tariffs is fully consistent with the careful scrutiny that the Commission has always given to LEC proposals to amend the general regulations in Section 2 of their LECs' interstate access tariffs. Far from being "receptive" to proposals to amend Section 2, as Verizon contends, the Commission has consistently emphasized that the general regulations in Section 2 of the incumbent LECs' tariffs must balance carrier and customer interests. Most of the regulations in Section 2, including the security deposit provisions, were either prescribed by the Commission or extensively rewritten by the Commission in the post-divestiture access tariff investigations in 1984 and 1985.[15] In those investigations, and in subsequent orders, the Commission has required that any regulations designed to protect the LEC's interests not place undue burdens on customers. In particular, the Commission has required that any regulations designed to protect the LEC's interests be limited in scope, commensurate with the risk faced by the LEC, and narrowly targeted to address the source of the risk.

For example, in considering security deposit provisions, the Commission has "recogniz[ed] that it is prudent for the telephone company to seek to avoid non-recoverable costs imposed by bad credit risks."[16] At the same time, however, the Commission has rejected "vague charges [that] could become unreasonably burdensome," provisions that "allow[ed] the telco unnecessarily broad discretion" and provisions that had "potential anticompetitive effects."[17]

Similarly, in the <u>1987 Access Tariff Order</u> the Commission "recognize[d] that the

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[15] Investigation of Access and Divestiture-Related Tariffs, <u>Memorandum Opinion and Order</u>, CC Docket No. 83-1145 Phase I, 97 FCC 2d 1082 (1984) (<u>Phase I Order</u>), Appendix D.
[16] <u>Phase I Order</u>, Appendix D, discussion of Section 2.4.1(A) (emphasis added).

proposed tariff revisions could reduce BellSouth's liability under the circumstances that it has described."[18] At the same time, however, the Commission "believe[d] . . . that [BellSouth]'s revisions may place undue burdens on customers . . . . Provisions that more directly applied only to those customers that might default and that are supported with adequate documentation would be more reasonable."[19] The Commission did not find BellSouth's proposal so unlawful as to warrant rejection, but imposed strict conditions that BellSouth was unable to meet.

The tariff changes proposed by Verizon in Transmittal No. 226, like the other ILEC security deposit tariff filings, do not provide the requisite balancing of carrier and customer interests. Rather than targeting security deposit requests to only those customers that present a substantial risk of nonpayment, the tariff language proposed by Verizon and the other LECs is so broad that it would permit the LECs to demand a security deposit from even those customers that present only a low or moderate risk of nonpayment. For example, as WorldCom explained in its petition to reject or, in the alternative, suspend and investigate Verizon Transmittal No. 226, Verizon's proposal to demand a security deposit from every customer whose debt is non-investment grade simply goes too far. Given that in most years less than 10 percent of non-investment grade companies default on their obligations,[20] Transmittal No. 226 would impose an unreasonable burden on hundreds of customers that present only a modest risk of nonpayment.

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[17] Id.
[18] Annual 1987 Access Tariff Filings, Memorandum Opinion and Order, 2 FCC Rcd 280, 304-305 (1986) (1987 Access Tariff Order).
[19] Id.
[20] Moody's Investors Service, "Default and Recovery Rates of Corporate Bond Issuers," February 2002, at 1 (http://riskcalc.moodysrms.com/us/research/defrate/02defstudy.pdf

III. The Commission should reject Verizon's invitation to serve as its co-counsel in future bankruptcy proceedings.

Verizon asks that the Commission "unequivocally support, *in any bankruptcy court proceedings in which it participates*, the right of carriers such as Verizon to receive payment in advance (or other measures such as security deposits) in order to obtain assurance of payment for the services that they continue to provide."[21] The Commission should make no such open-ended commitment to support the interests of any particular group of creditors in a bankruptcy proceeding. It is the duty of the bankruptcy court itself to determine what constitutes adequate assurance of payment when the parties in interest disagree. The Commission has no particular interest or expertise in this determination and should leave it to the prerogative of the court.

Verizon appears utterly confused about the respective roles of this Commission and a bankruptcy court. It bemoans the fact that while advocating that carriers be required to ensure continuity of service and a reasonable transition for customers, the Commission has not "emphasized the equally important interest of carrier-suppliers to continue to receive payments throughout the bankruptcy process."[22] Of course, the latter interest is one that lies at the core of the Bankruptcy Code, not the Communications Act. Moreover, the Commission could rightly conclude that Verizon and other "carrier-suppliers" are perfectly capable of standing up for their own interests in bankruptcy proceedings, but that consumers and the protection of the public interest, which are central to the Communications Act, might need the Commission to advocate on their behalf.

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[21] Verizon Petition at 6. Emphasis in original.
[22] *Id.*

Section 366(b) of the Bankruptcy Code requires the debtor-in-possession, within 20 days of filing, to give utilities such as Verizon adequate assurance of payment. If the utility and the debtor-in-possession do not agree as to what constitutes adequate assurance, the matter can be submitted to the court to decide what assurances will be adequate. Thus, the Bankruptcy Code provides an explicit process to protect the interests of utilities such as Verizon. Bankruptcy courts have the experience and expertise that is necessary to balance the interests of all parties. There is simply no basis for the Commission to assume that it knows better than a bankruptcy court how to balance those interests so as ensure the adequacy of the assurances that are given.

Verizon claims that, in some cases, bankruptcy courts have concluded that a right to terminate service in case of default is sufficient, but that, as a practical matter, this right has proven illusory since regulators wish to avoid abrupt termination of service.[23] Assuming that this is accurate, it is a matter best brought to the attention of the bankruptcy court. Verizon undoubtedly employs skilled attorneys who can present this argument to the appropriate court.[24] Then, in the context of a particular bankruptcy, that court will determine what assurances are necessary. In some cases, the court may require advance payment or a deposit. In others, the court may find that other assurances are adequate. Since the court, which is charged by statute with this determination, will not pre-judge the outcome of such an adjudication, it would be completely improper for the Commission to do so by committing in advance to take the side of a faction of creditors in every dispute over

[23] *Id.* at 7.

[24] Indeed, Verizon made many of these arguments in the WorldCom bankruptcy proceedings. The court found, however, that security deposits were not necessary to provide Verizon with "adequate assurance." *Order Pursuant to Sections 105(a) and 366(b) of the Bankruptcy Code Authorizing WorldCom to Provide Adequate Assurance to Utility Companies*, August 14, 2002, Case No. 02-13533 (Bankr. S.D. N.Y.)

the adequacy of assurances.

IV. The Commission's only role with respect to cure issues is to protect customers from the exercise of market power by dominant carriers such as Verizon.

Verizon has asked the Commission to declare that "nothing in the Communications Act denies carriers serving bankrupt customers of carriers' well-established rights under the Bankruptcy Code (and binding federal tariffs) to obtain a cure of prior indebtedness from carriers that receive the benefit of the bankrupt's existing service contracts."[25] This request is both procedurally defective and substantively misguided (as well as being nearly incomprehensible). Indeed, the only role for the Commission in disputes related to cure issues is to protect customers from the exercise of market power by dominant carriers such as Verizon.

Declaratory relief is available to terminate a controversy or to remove uncertainty when the facts are clearly developed and essentially undisputed, and the governing law is clear.[26] There must be a controversy raised by clearly developed, undisputed facts, governed by clear legal principle or precedent, and which the requested declaration would terminate. In this case, Verizon has not associated its request with any particular controversy.[27] Instead, Verizon has sought a general ruling abstracted from any actual dispute. Declaratory relief is simply not available in this instance.

Moreover, even if declaratory relief were appropriate, the declaration sought by Verizon would ignore several critical issues that the Commission would have to address in any evaluation of the cure demands of a dominant carrier such as Verizon. These issues are

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[25] *Id.* at 8.
[26] *American Network Inc.*, 4 FCC Rcd 550, 551 at ¶ 18 (CCB 1989).

[27] It is true that Verizon previously sought a declaratory ruling on a dispute that it was having with Winstar.

so significant that the Commission should promptly open a proceeding and solicit comment on how best to fulfill its statutory obligation to protect customers from unjust and unreasonable demands by dominant common carriers in the context of cure negotiations.

Verizon asks the Commission to declare that successors to bankrupt entities must treat existing service arrangements purchased under tariff as "executory contracts," the assumption of which triggers cure obligations under section 365 of the Bankruptcy Code. This is little more than question-begging. Only in the event that a bankruptcy court made the determination that existing service arrangements constituted executory contracts would the Commission have any role in overseeing the assumption/rejection process to ensure compliance with the requirements of the Communications Act. In that circumstance, the question is not whether cure obligations exist -- only the bankruptcy court can answer that question -- but whether cure demands are just and reasonable and whether a carrier is using market power in an attempt to extort unreasonable cure amounts from a captive customer.

Equally to the point, Verizon appears to be suggesting that it has the right under the bankruptcy law to have all pre-petition obligations satisfied if some other entity were to be assigned contracts necessary to the assigned services, or that it has the "right" to such payments from the debtor itself. Verizon grossly misstates the law. While Verizon is of course correct that executory contracts may not as a general matter be assumed unless defaults are cured, it ignores that such contracts may also be *rejected*, in which case there is no cure under the law. Verizon's suggestion that carriers that may choose to reject particular contracts are "gaming" the system is directly contrary to the bankruptcy law. Indeed, for Verizon even to request that the Commission take the position that Verizon has a

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But Verizon has not limited this request to the facts and circumstances surrounding that dispute.

"right" to have its pre-petition obligations paid is arguably a violation of the bankruptcy law, which prohibits the "employment of process . . . of an administrative . . . proceeding against the debtor . . . to recover a claim against the debtor that arose before the announcement of the case under this title." 11 U.S.C. § 362(a)(1).

Moreover, even if the estate ultimately decides to assume executory contracts, a communications company emerging from bankruptcy may find itself with existing service arrangements purchased from a number of carriers. While some of those carriers will be upstart competitors, others will be dominant, incumbent monopolists such as Verizon. Assuming cure obligations are owed to both groups, the Commission must ensure that dominant carriers do not exercise their market power to obtain greater cure payments than non-dominant carriers. Dominant carriers are likely to attempt to wield their market power in a number of ways in this context. The Commission has a statutory duty under sections 201 and 202 of the Communications Act to thwart such attempts.

The most obvious source of market power in this context is the fact that for the vast majority of its existing service arrangements, the purchasing carrier may have absolutely no alternative to the dominant carrier. In Verizon's service area, its network dwarfs that of all its rivals combined. There is no doubt that, in many cases, Verizon is the only provider of service to particular premises or on particular routes. Meanwhile, in almost every case there will be at least one alternative to service provided by a non-dominant carrier (i.e., Verizon). In many cases, there will be several alternatives, since competitive networks tend to be clustered in high-teledensity areas.

Since Verizon will, so often, be the only available provider, the entity emerging from bankruptcy will not be able to reject executory contracts with Verizon based on its ability to obtain substitute service from another provider. Instead, it will have no choice but to do business with Verizon. Verizon can use this advantage to insist on greater cure payments than a competitive carrier could obtain. The Commission must not allow this to happen. Dominant carriers are not entitled to greater cure payments than non-dominant carriers.

Dominant carriers may also be able to exercise market power by threatening to disconnect huge numbers of circuits at once if the successor entity refuses its cure demands. This threat creates a logistical nightmare for the purchaser and its customers, even if alternative providers are available. It may be simply impossible to manage the mass-migration of an entire circuit base to other network providers. In this circumstance, the Commission must step in and require the dominant carrier to cooperate in a phased transition plan in which service is migrated over as long as period of time as is necessary to avoid needless customer impacts.

These examples suggest that the post-bankruptcy period may provide dominant carriers with a unique opportunity to disadvantage their rivals. The Commission should promptly issue a Notice of Proposed Rulemaking to establish rules to restrain dominant carriers in these circumstances. Among other things, the Commission should solicit comment on the ways in which dominant carriers may attempt to wield market power in cure negotiations, the relative size of cure demands made by competitive carriers and dominant carriers in recent post-bankruptcy negotiations, and whether dominant carriers have made different types of demands based on the identity of the post-bankruptcy entity and whether the dominant carrier has any equity or other interest.

V. Conclusion

For the reasons stated herein, the Commission should decline to act on Verizon's petition.

Respectfully submitted,
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